DOW THEORY LETTERS INC.

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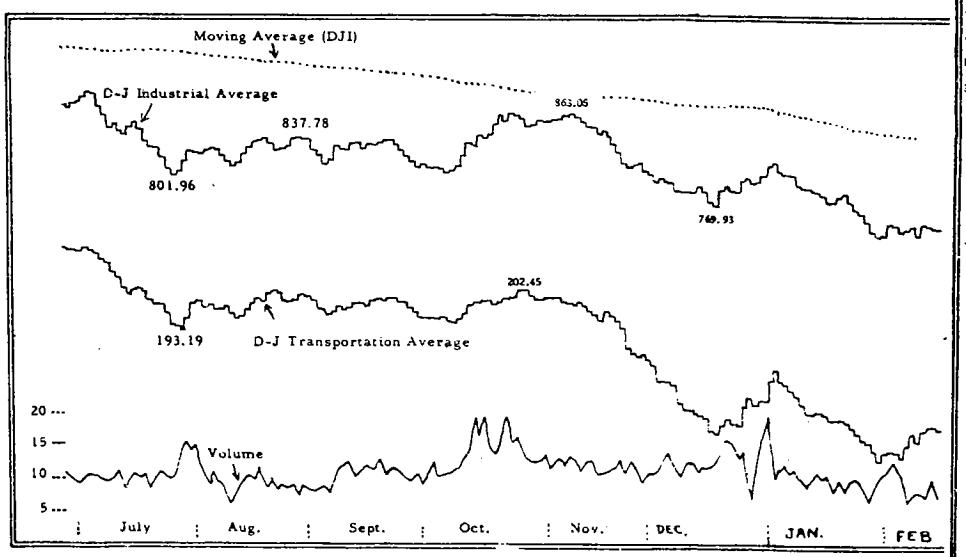
THE MARKET: President Nixon's economic advisors have done what no other Administration's "helpers" have ever done on an official basis. They have tried to project economic, social and therefore money needs five years hence. I don't think it will work. I don't think their crystal balls are worth a darn, but at least they did try.

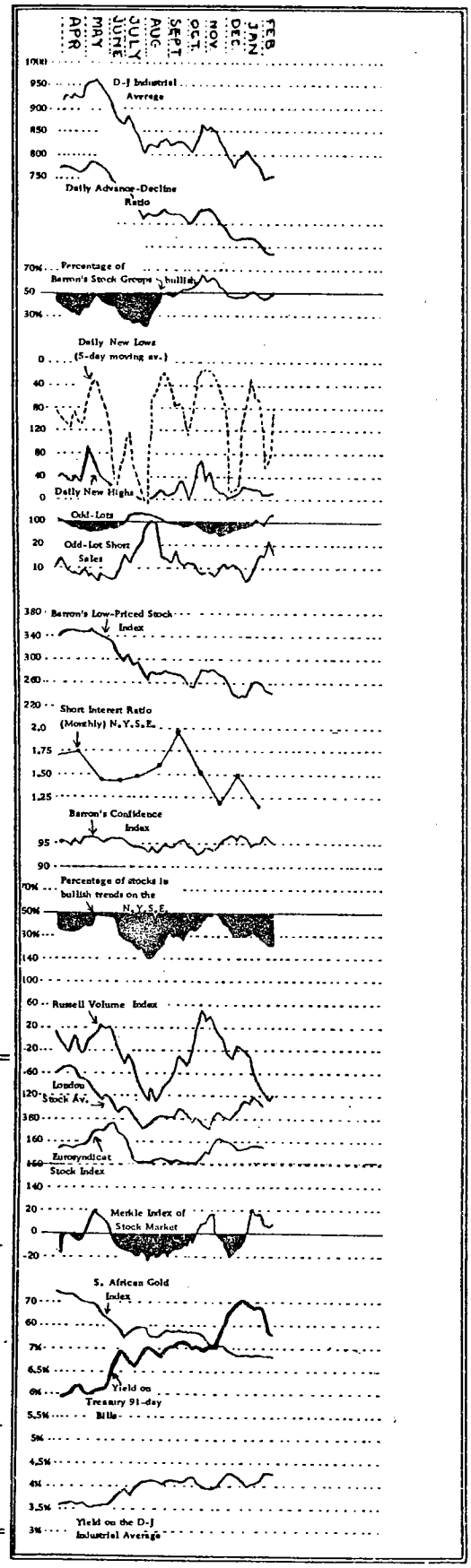
The advisors see a G.N.P. growth increase of $400 billion by 1975, and this is to produce total annual revenues of $266 billion or about $64 billion more than today. But, the advisors note, most of this projected increase in revenues will be used up. $20 billion will go for inflationary government pay increases, $16 billion for new programs already proposed and $8 billion in increased costs to existent programs. That leaves the amazingly insignificant sum of $22 billion for new projects, assuming no unforeseen emergencies such as another Vietnam. Among the knowledgeable, the report was a shocker.

Personally, I doubt whether the government can even be accurate regarding their tax receipts for the current fiscal year, but I have to admire the boys in Washington for at least trying to plan ahead. After all, President Johnson tried to fight a war without any financing at all, and he very nearly broke the nation in the process. So I can't fault Mr. Nixon for attempting to be business-like. I'm merely skeptical as to the accuracy (and therefore usefulness) of his projections.

In the meantime, the national version of the G.N.P.—guessing game seems to be guessing when the bear market will be over. I consider this exercise just as hopeless as the Administration's economic projecting. Major primary bear markets follow an "unraveling" process as one set for unfavorable factors touches off two more unfavorable factors, and the two more set off another four. Thus, the "surprises" build up, and market predictions are tossed, one by one, into the waste baskets of brokerage offices and advisory services the world over.

So far on Wall Street, everything appears to be well in hand. There have been few surprises, no shocks, no 180 degree reversals in crowd psychology, no general smash in speculative shares (note the resistance on the downside on the Amex), and no black pessimism regarding common stocks. Quite the contrary, everyone




D-J Industrial Average
Daily Advance-Decline Ratio
Percentage of Barron's Stock Groups bullish
Daily New Lows (5-day moving av.)
Daily New Highs
Odd-Lots
Odd-Lot Short Sales
Barron's Low-Priced Stock Index
Short Interest Ratio (Monthly) N.Y.S.E.
Barron's Confidence Index
Percentage of stocks in bullish trends on the N.Y.S.E.
Russell Volume Index
London Stock Av.
Eurosyndicat Stock Index
Merkle Index of Stock Market
S. African Gold Index
Yield on Treasury 91-day Bills
Yield on the D-J Industrial Average

 is simply wondering when the right time will arrive to pile back into equities. More and more analysts are talking about the "rosy" second half of 1970 or "the better 1971". That's not the kind of psychology I associate with the end of a bear market. Major primary bear markets generally end when the public and most of the professionals are driven out of stocks. Bear markets end with pessimism, disillusionment and skepticism about any "coming period of better times."

I see nothing of this type of psychology, either in public sentiment or in technical market measurements. As for the latter, odd-lot action hardly suggests that the bear market is over, the still high Low-Priced Stock Indexes do not suggest a "give-up" psychology, average yields on stocks (S & P broad 500 Index yielded 3.73% last week) do not even hint of the end of the bear trend.

One of the worst things about a primary bear market is that it is likely alternately to break you, then bore you to death. The 1969-70 decline went some distance towards breaking investors, and the rest of 1970 could possibly bore us silly. I have been sitting here at my desk reading all the "100-points up" and "100 points down" predictions, and I have been wondering what could happen in 1970 to drive us all up the wall. I almost hesitate to state (the market might be "listening") that a 75 or 100 point trading affair could do the trick. Personally, I hope that 1970 does produce a reasonable quantity of action such as a good upside correction or (if need be) a further drop into the depths below (as that will at least take us nearer the end of this affair). So I suppose I am really just steeling myself for anything which may lie ahead.

In all fairness, my subscribers and I should be ready for anything, since (and I hope I'm correct) we are out of this market and watching on the sidelines. The truth is that all the action ahead during this bear market is going to be academic to me, and I'm not going to take any money out of safekeeping until I am convinced that the bear has breathed his last. I'll be only too eager to tell subscribers when I think that time has arrived, but until then may I suggest "the waiting game". And a very exasperating and difficult game it can be (since the bear market will use every trick in its repertoire to try to lure us back into swapping our cash for stock certificates again).

Turning to the nearer term, I want to discuss one factor, and that is the daily new lows. Here are some critical figures. July 30, 1969, my 5-day average of daily new lows was at 528 with the Dow at 801.96. December 18, 1969, 5-day average at 252 with Dow down to 769.93. January 30, 1970, 5-day average of new lows at 182 with Dow at a new bear market low of 744.06.

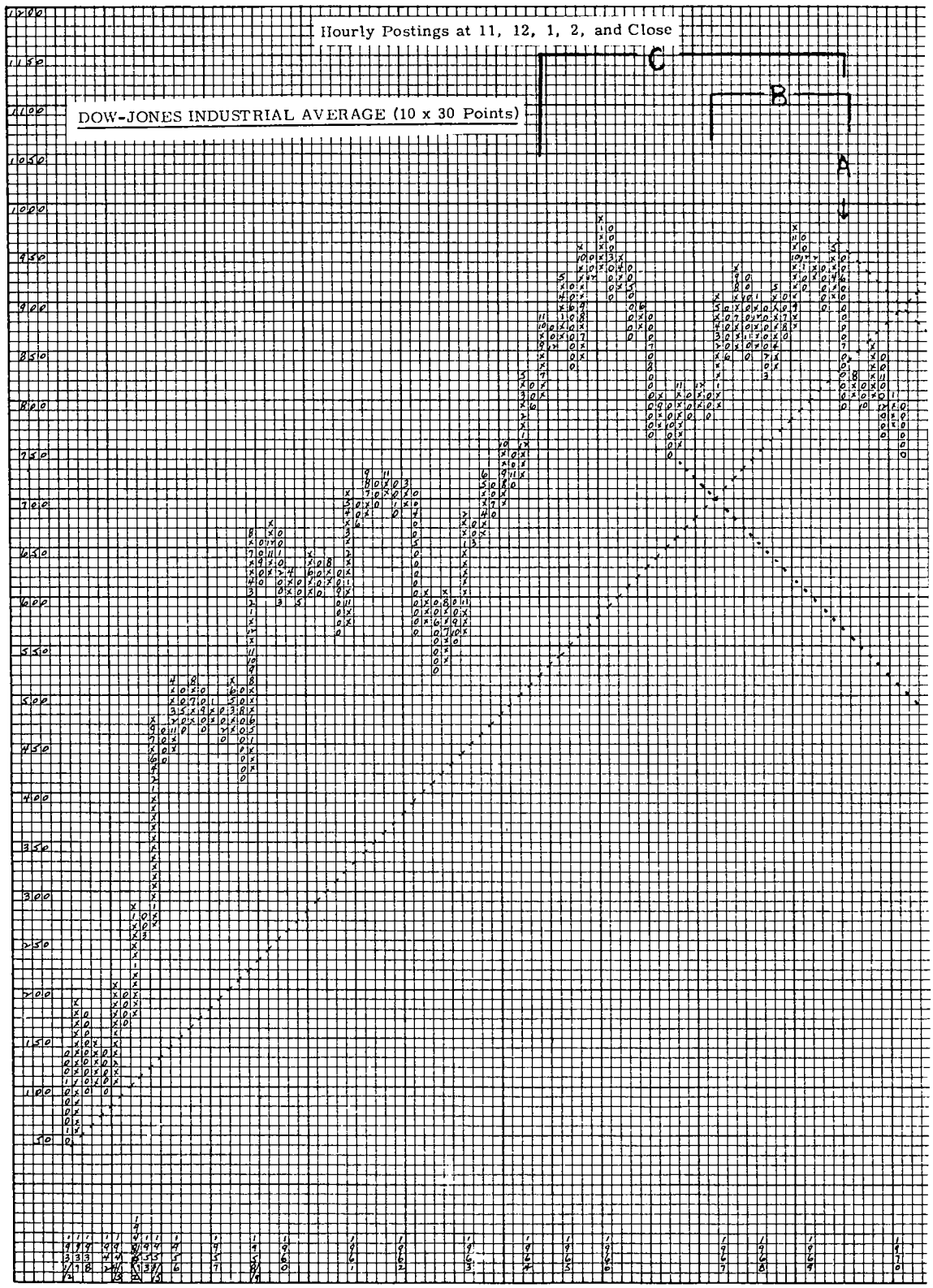
What does this mean? Why are new lows shrinking as the Dow descends? It could mean that the downside pressure is subsiding and that the market is getting ready to mount a good advance. It could, in other words, mean that many stocks are forming bases. Or it could mean that in the earlier phase of the 1969-1970 decline "everything" was going down and by January, 1970, the decline was simply becoming more selective.

During a primary bull market any cessation of downside momentum (such as decreasing new lows as the market drops) constitutes a hopeful sign. During a primary bear market, I do not take ebbing downside momentum as seriously as I would during a continuing bull market. I have given a good deal of thought to the matter, and I feel that the recent decline in daily new lows seems to be calling for a rally attempt. In fact, the market has been trying to mount a rally ever since the January 30 low of 744.06 on the Dow.

So far, it is too early to tell whether this is going to be an impressive upside push— or simply another washout. I note with caution, however, that almost every investment service is now calling for a good rally, and this alone makes me suspicious. But let's give the market the benefit of the doubt. It's been a long, hard descent from the December, 1968 high of 985.21. A rally is certainly overdue. And the bear might need a rest before showing all his teeth again.

POINT & FIGURE: One of the oldest methods of charting is the point & figure method. I have read a good many books on this technique, I have discussed it with experts, I have followed P & F both in individual stocks and the averages for years. Alot of what I am going to write now is pure theory, but we are now (I hope) sitting on the sideline in a major primary bear market, and why not waste a little time on theory? Personally, I find theoretical studies of the stock market fascinating, and I hope my readers will too.

Nobody knows exactly when the P & F method of charting originated. The book, "The Game in Wall Street and How to Play it Successfully" (published in 1898) by "Hoyle" (believed to be J.M. Klein) is evidently the first book on the subject. I own Victor deVilliers' book, "The Point and Figure Method of Anticipating Price Movements," and this is the first definitive book on the subject. Charles Dow is said to have employed P & F studies between 1891 and 1901. At any rate, P & F is an old and established technique, and it can be applied to any market.



P & F charts deal only with movement. The method is not interested in time nor is it interested in volume. According to P & F theory, price makes the volume, and price changes make the chart. Whether a given formation is constructed in a month or a year makes no difference in P & F theory. It is the structure itself which is important.

The accompanying chart has appeared here before (chart courtesy of Chartcraft, Larchmont, N.Y. 10538). It is a 10-point, 30-point reversal chart going back to 1932. Each square on the chart represents 10 points on the Dow Industrials; only reversal movements of 30 points or more are shown. The vertical rows of X's indicate rallies of 30 points or more, while the O's denote declines of 30 points or more. Dates are shown at the bottom on the chart.

One of the least understood facets of P & F is the "count," or the prediction of the extent of a move. Many P & F experts state that the count is the least important element of P & F work, but I never met a P & F technician who did not take the count once a chart turned bullish or bearish.

Of course, the count is a theoretical device, based merely on empirical evidence or past experience. The count is hardly a "sure thing", and it may not work at all in many instances. However, the count is more likely to work with the primary trend. In other words, the bearish or downside count is more likely to work during a bear market (I would distrust an upside count during a bear market) and the converse is true during a bull market. The count does at least set up possibilities, and I will go into some of the possibilities inherent in this chart now.

Chartcraft prefers what is known as the "vertical count". The vertical count is based on the extent of the first breakout movement. For instance, referring to the chart, note at the column marked A that the Dow dropped a straight-line total of 16 boxes or 160 points. Since this is a 30-point reversal chart, we multiply the 160 by three and this gives us a huge downside count of 480 points. This 480-point downside count is taken from the preceding row of X's, which in this case was the May high of 960. Thus the downside vertical count is 960 minus 480 or 480. There is no time limit on the P & F count, but according to P & F theory the downside vertical count is indicating an ultimate potential low of 480 on the Dow.

The more widely followed count is the "horizontal count". This procedure states that a horizontal count of the boxes which make up the top formation indicates the extent of the move. The wider the top, the greater the potential downside move (obviously, the reverse is true during bull markets).

The most conservative horizontal count I can come up with on this chart is the horizontal count shown in the bracket marked B. The B bracket embraces a top which is 14 squares or 140 points across. Multiplying by three (because it is a 30-point reversal chart) gives us a downside count of 420 points. The count is taken from the extreme high of the formation which is the November, 1968 P & F high of 980. Subtracting 420 from 980 gives us a horizontal downside count of 560.

Just to scare myself, I have taken the whole massive formation from 1964 to 1969 and labeled this whole structure a top. The structure is encompassed by the bracket marked C. The horizontal count across bracket C is 32 boxes or 320 points. Multiplying this by three gives us a downside count of 960 taken from the 1966 top or extreme top of 980. This procedure gives an ultimate count of 20 for the Dow, a rather frightening thought. It also seems a rather outlandish thought, assuming the nation is to survive, so conservative practice would have us start with the downside count as shown in the B bracket.

As a final consideration, a 45 degree trendline often shows important resistance. Drawing a 45 degree trendline from the last important bottom, which was the 1966 bottom, provides us with an idea of where the next important downside resistance may appear. At present, if the market were to continue straight down the trendline resistance from the 1966 base would come at about 510 on the Dow. This figure is particularly interesting since it is close to the vertical downside count which was 480, and it is also close to the horizontal count based on the B top which was 560.

Thus, both the vertical count, the horizontal count from B and the trendline resistance all fall within the 480 to 560 range. I would therefore say that from the standpoint of P & F theory, the expectations would be for the Dow to drop (in due time) into the 480 to 560 area. If this does occur, there will doubtlessly be new counts and new implications to discuss. Those implications, as always, will be covered in these Letters.

ODD-LOT SHORT SALES: What I am going to say here is not going to offer final proof of anything. But it is going to present suspicions. In the last Letter I said that I spoke to Garfield Drew regarding the latest figure on this three-month moving average of the odd-lot short sales index. The latest figure for January was 9.6.

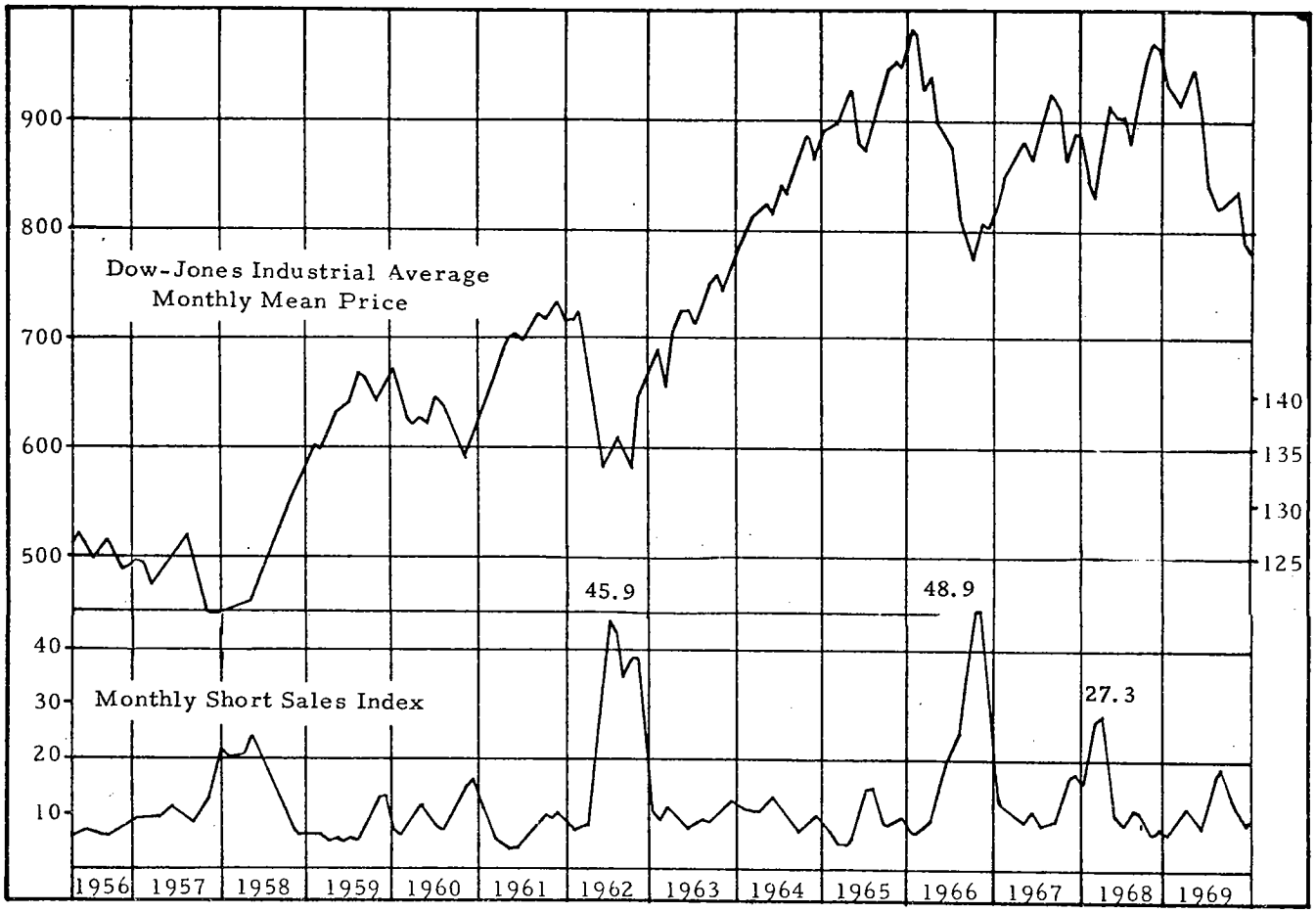
Now there is no way of "proving" that a bottom can't arrive with the odd-lot shorting index at 9.6. But we can say that in the past, going back as many years as you want, no bottom following a major drop such as the one which occurred in 1969-70, was ever associated with an odd-lot short index figure of 9.6.

Drew's short index figures are not based on volume of odd-lot short sales. They are based on the ratio of odd-lot short sales to total short sales. Thus, these figures are not affected by a net drop-off in odd-lot volume. They are affected only by changes in odd-lot sentiment.

I am including a chart on page 5 (courtesy of Drew Odd Lot Studies, 50 Congress St., Boston) showing the Drew odd-lot short index going back 14 years to 1953. Here we see the 1957 decline bottoming out with a figure of over 20 on the Index. Next, the comparatively mild 1960 reaction ended with a figure of 16 on the Index.

The next two major market declines are much more comparable in intensity and character with the 1969-70 decline. The first, that of 1962, took the Dow down 199 points. At the bottom the odd-lot short index rocketed to 45.9, showing a great rate of odd-lot shorting activity. The next major decline or the 1966 affair erased 251 points from the Dow while establishing an odd-lot short index record figure of 48.9.

In 1968 a lesser decline produced a respectable short index figure of 27.3. So finally, we get to the latest 1969-70 smash. From the December, 1969 high of 968, the Dow by February sustained a huge loss of 224 points. Yet the odd-lot short index figure for January, the month of the low, registered only 9.6.



Based on all the preceding evidence, the January 9.6 figure for the odd-lot short index indicates a decided and remarkable lack of bearishness among odd-lot short sellers. In fact, compared with the odd-lot short figures of recent history such as the 48.9 figure of 1962 and even the 27.3 figure of 1968, it appears that the odd-lot short sellers remained extraordinarily uninterested in the 1969-70 decline.

Can the 9.6 index figure be associated with an important bottom? It hardly seems so, although on Wall Street anything can happen. Personally, I am of the opinion that the low odd-lot short index figure of January, 1970, might be accompanied by a "psychological rally" broght on perhaps by the hopeful statement of Mr. Kennedy and Mr. Burns. But as I see it, no great amount of bearishness existed at the January, 1970 low. Certainly not the kind which was associated with other important bottoms. Therefore, regardless of any temporary rally of a few weeks or months, I am of the opinion that by the end of the year the Dow could be substantially and perhaps shockingly lower than it was at the January low.

NOTES & QUOTES: One current Wall Street game is trying to read Mr. Arthur Burns' mind. I am indebted to my friend Harry Schultz for providing the following from an April, 1968 speech by our new Federal Reserve Board head: "Unless our BOP deficit is soon corrected, the two-tier gold system will probably collapse. In that event, we may have to choose between sharply raising gold's official price or letting the dollar float. Either answer would mean dollar devaluation..... Foreign support for a floating dollar is conceivable, but it's unlikely to last. A foreign country has an alternative to accumulate dollars it doesn't want, it can let the dollar depreciate and restrict imports. In the end, a floating dollar would result in unsettled business, restrictions, and political turmoil. On the other hand an increase in the gold price would leave the present exchange rates system virtually intact, so business could go on as before.....A substantial increase in the gold price would give us time to work towards financial prudence.....If we are unwilling to practice austerity on a sufficient scale, then an increase in the price of gold is the wisest choice open to us."

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Sidney Homer (partner in Salomon Bros. & Hutzler) and a top bond expert stated on February 9 that a recession alone will not cure the bond market. He stated: "A cyclical recession this year, while bringing rates down temporarily, will not

cure the fundamental ills of our market unless either business psychology turns sharply down or confidence in a sound fiscal policy is restored. The fundamental explanation of the giant rise in interest rates," he continued, ".....lies in the new conviction of the business community that the federal government will not only abolish business recession, but will also spend unlimited sums in the years ahead for urgent social programs."

In other words, in the face of sluggish consumer demand and fiscal and monetary restraint, in the face of factory capacity down to a low of 82%, American businessmen still continue to think the way they have (correctly) thought over the past 25 years. Thus we have the strange spectacle of business moving into recession and still planning vast factory expansion, all based on the thesis that the government will "turn this thing around anytime it wants." But what if the government is in no position to "turn it around?" Of such predicaments are panics made.

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In his Weekly Bond Buyer (Feb. 2) column, Eliot Janeway explodes the myth that Mr. Nixon has the budget well in control. Indeed, he talks about ".....the disgraceful and disastrous way in which his (Nixon's) Administration has allowed itself to be suckered into carrying on with, and therefore being responsible for, the bungling of the supposed campaign against inflation." Janeway explains that Arthur Burns has hardly been taken in by the current Administration "anti-inflation" campaign, and this is why "....the Fed is not about to lift the squeeze in which the credit markets are caught."

According to announced budget projections, Mr. Nixon should have about a $1.9 billion surplus for the coming fiscal year. This is indeed a narrow margin for an over $200 billion budget during a year when corporate profits are being squeezed. I agree with Mr. Janeway that if Wall Street is counting on Mr. Burns being a sucker, it may be taking the wrong count. And if Mr. Nixon is counting on the budget producing a surplus, he too may be counting on super-miracles.

* * * *

Last week the highly influential Federal Reserve Bank of New York reported that "Despite the current slowing of economic activity, there has been no apparent effect as yet on the rate of inflation." The report noted that industrial output, new orders for durable goods and housing starts continued to slow in December, but wholesale prices for industrial goods climbed at an annual rate of 4.2% in both December and January. Finally, in a comment which makes one wonder about a forthcoming easing in Fed policy, the report states: "Recent increases in consumer prices belie earlier indications of slowing in the rate of inflation."

NOTE: Credit for the chart of the 40-Bond Average in Letter 448 goes to Mr. C. Coleman Petty, Louisville, Kentucky. The chart appeared recently in Trendway Advisory Service also of Louisville, so courtesy is extended to my friends at Trendway as well. Mr. Petty, unlike most bond "experts," has a thorough historical knowledge of the bond market. In a study received here today, Mr. Petty notes that historically the 40-Bond Average almost always tops out and bottoms out just prior to tops and bottoms in the stock market. Mr. Petty, through his own calculations, believes that the 40-Bond Average could bottom around the very end of 1970 at a price of 61.45 (note: the 1932 bottom was 65.78). If this proves correct, Mr. Petty is of the opinion that the stock market will bottom out roughly a month later or in early February, 1971. Sounds reasonable to me, but if it's true there is going to be a lot more trouble ahead.

SECOND NOTE: Advance Planning Consultants of New Orleans has prepared a most interesting cardboard bound booklet entitled "The Impending Monetary Collapse." I found this booklet very informative and packed with useful information. The work encompasses gold, banking and credit, money theory, the Federal Reserve System and investing during crisis.

The price of this booklet is $15, and I have agreed to take orders for the booklet. Those interested please send a check for $15 made out to Dow Theory Letters. For those interested in a valuable, fundamental grasp of the monetary situation today, I recommend this work.

STOCKS: The collapse in the oils has been breathtaking and ominous to say nothing of being costly. Here we see Standard of New Jersey with 215 million shares outstanding dropping 40% in a period of 7 months, while Texaco with 272 million shares outstanding has erased 43% of its value in a like period. It is of interest that funds, pension plans and college endowment funds hold huge amounts of these companies. Primary bear markets tend to be democratic; they hurt everybody regardless of wealth or status.

Charts courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kans.